

**Kontoor Brands**  
**Second Quarter 2022 Earnings**  
**August 4, 2022**

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**Presenters**

**Scott Baxter, President and CEO**

**Eric Tracy, Vice President, Corporate Finance and Investor Relations**

**Rustin Welton, Chief Financial Officer**

**Q&A Participants**

**Mauricio Serna – UBS**

**Bob Drbul – Guggenheim Securities**

**Paul Kearney - Barclays**

**Brooke Roach - Goldman Sachs**

**Will Gardner - Wells Fargo**

**Operator**

Good day, ladies and gentlemen, and welcome to the Kontoor Brands Q2 2022 Earnings Call. All lines have been placed on a listen-only mode, and the floor will be open for questions and comments following the presentation. If you should require assistance throughout the conference, please press star, zero on your telephone keypad to reach a live operator.

At this time, it is my pleasure to turn the floor over to your host, Eric Tracy, Vice President of Corporate Finance and Investor Relations. Sir, the floor is yours.

**Eric Tracy**

Thank you, operator, and welcome to Kontoor Brands' Second Quarter 2022 Earnings Conference Call. Participants on today's call will make forward-looking statements. These statements are based on current expectations and are subject to uncertainties that could cause actual results to materially differ. These uncertainties are detailed in documents filed with the SEC. We urge you to read our risk factors, cautionary language, and other disclosures contained in those reports.

Second quarter 2022 results are on a GAAP basis. Select comparisons to 2021 results will be on an adjusted dollar basis. And in certain cases, we will make comparisons to 2019 results, which we clearly define in the news release that was issued earlier this morning and is available on our website at [KontoorBrands.com](http://KontoorBrands.com).

Reconciliations of GAAP measures to adjusted amounts can be found on the supplemental financial tables included in today's news release. These tables identify and quantify excluded items and provide management's view of why this information is useful to investors. Comparisons will be in constant currency unless otherwise stated.

Joining me on today's call are Kontoor Brands' Chief Executive Officer and Chair, Scott Baxter, and Chief Financial Officer, Rustin Welton. We anticipate this call will last about an hour. Scott?

**Scott Baxter**

Thanks, Eric, and thanks, everyone, for joining us today. I want to start today's call by sincerely thanking our colleagues around the world. I have been greatly humbled by our team's agility, collaboration, and resolve to not only persevere through these dynamic times but deliver on our near-term operational results and drive industry-leading TSR since our spend, all while continuing to position Kontoor for greater long-term success.

And let's be clear. To say the macroeconomic environment has been dynamic simply isn't enough. Let's call it like it is. It's been downright difficult. From the COVID pandemic and lockdowns to the war to supply chain disruptions to inflation, pressures that companies, consumers, and people around the world have and continue to face are unprecedented. And as we've discussed on many of our recent quarterly calls, Kontoor has not been immune to these obstacles.

In addition to, and in the face of, these challenging times, we at Kontoor have executed a spin-off, stood up an independent company, implemented a new global ERP system, and set the foundation for our catalyzing growth strategy. And as you'll hear more about today, we are further globalizing our operating model, including relocating our European headquarters.

We're really excited about these initiatives as they better position us to attract world-class talent in the region, unlock significant benefits for our organization, and further support the transition to a growth-oriented model. We knew our journey would not be easy. We knew it wouldn't be linear.

But, as we sit here today, and even with near-term macro challenges, our strategies to further strengthen our brands, operating model, and organization over the last three years have been tremendous. But, they can't and don't transform our business and some of the legacy challenges overnight. This requires time and sustained execution. I will provide greater insights on how we intend to do this in a bit. But, first, let me touch on our second quarter results.

Despite the uneven operating environment, we were able to expand share, POS, and AURs to drive top-line strength in our core U.S. business and were still able to deliver on our profitability goals, with operating income up over 50 percent year-over-year and earnings up 57 percent, coming in at the midpoint of our guidance range.

Now, this bottom-line strength didn't come without some incremental headwinds, including inflationary pressures and the much-discussed retailer inventory rebalancing that caused the supply/demand pendulum to aggressively swing as the second quarter progressed. While we

had anticipated these factors would more fully weigh on second-half results, they somewhat tempered our strong underlying brand momentum, impacting our top line sooner than we expected.

That said, global growth was still strong, up 27 percent in constant currency. The expected declines in our international business, owing to China lockdowns and timing shifts, impacted compares in Europe, were more than offset by strength in the U.S. with both the Wrangler and Lee brands up at least 40 percent domestically.

These gains in our largest market were supported by the breadth in development of our product portfolio in Q2. Highlights in Wrangler included the women's modern collection, augmented by the work wear and Western categories. In fact, Western summer seasonal bookings were up double digits. In addition, the brand's product evolution once again saw strength in outdoor ATG and growing momentum of its fishing sports specialty line, Wrangler Angler.

At Lee, men's saw really strong performance within core denim, casuals, and seasonals, with the brand driving share gains across all male categories in the quarter. Womens, too, experience solid double-digit growth as innovation platform's Flex Motion and Ultra Lux supported the gains.

Stepping back a bit from just our second quarter results versus last year, I think it's an important perspective to look at the first-half performance compared to pre-pandemic first-half 2019, providing a more normalized assessment of the business. It also gives a better indication of how we believe our strategies have, and should continue, to drive diversified accretive growth across our core channels, categories, and geographies.

Compared to the first half of 2019, first half 2022 global revenue increased 5 percent but more importantly increased 13 percent, excluding our proactive actions taken with VFO in India. In terms of our core U.S. business, Wrangler and Lee increased 19 percent and 14 percent respectively over first-half 2019 levels.

In our largest market, both brands have driven significant share gains in the core men's denim casual bottoms business over first-half 2019, with Wrangler up 80 points and Lee up 60 points and would be even greater if not for our proactive quality of sales actions to exit certain points of distribution.

Importantly, AURs, driven by mix, have also increased over this time period, up double digits in the U.S. for both brands, supported by innovation, digital, and expansion of the brands to more premium points of distribution.

Turning to our channel diversification with a focus on digital. Our first half 2022 global own.com increased 111 percent, and our U.S.-owned.com increased 140 percent, compared to

2019. How have we been able to deliver this performance, despite the multitude of macro challenges?

By making the long overdue investments to support these brands like never before in key growth enablers such as talent, demand creation, and innovation. From a demand creation perspective, both Lee and Wrangler continue to amplify brand heat (sp) and have exciting plans for the balance of the year.

First with Lee. The team continues to enhance marketing efforts to elevate brand positioning, particularly within digital spend, integrated seasonal demand creation, including the streaming summer campaign, Free Your Originality, by Lee Originals, drove holistic digital experiences across consumer touchpoints, supporting 61 million digital media impressions and a 103 percent year-over-year increase in social media traffic during the quarter.

Authentic. Brand right partnerships also remain key in Lee's premiumization strategies, including the second draft (sp) of the highly successful collab with The Hundreds that launched in May. And perhaps the most exciting moment in Q2, and reflective of how different the brand is showing up in the market compared to years past, Lee sponsored Bonnaroo Music Festival in June, celebrating American culture in the spirit of originality.

Brand activation events were highlighted by the original Lee Tree, not only a one-of-a-kind piece of art made of 900 square feet of Lee denim scraps, but an interactive brand experience that allowed music goers and brand aficionados, old, and importantly new, to leave their mark by decorating the tree with additional leaves throughout the festival.

It is exactly these types of demand creation investments that have helped support Lee's elevated brand health, reflected in Q2, domestic men's denim, casual bottom share teens (sp), which increased 50 points over last year and AURs that increased 22 percent over 2019 levels.

With Wrangler, the brand's 75<sup>th</sup> anniversary celebration continued in the second quarter, with demand creation efforts through our For the Ride of Life campaign, and elevated social media platforms, allowing the brand to reach new consumers like never before.

Similar to Lee, distorted investments in digital drove meaningful growth, including 73 million additional media impressions, and significant year-over-year growth and traffic to Wrangler.com. Authentic collaborations, such as our recent partnership with iconic music brand Fender highlights how the Wrangler brand plays at the heart of cultural influence.

Augmenting the Fender collab, Wrangler has further leaned into its brand connection with music to catalyze consumer engagement. Acting as the exclusive denim sponsor of the two Lollapalooza Music Festivals in Chicago and Berlin, as well as Austin City Limits, a collaboration with these three iconic music festivals celebrating self-expression and shared passion through

music, fashion, and culture, kicked off with our 75 days of summer, a sweepstakes offering 75 days of prizes to destination music festivals.

In the Wrangler booth, an interactive customer space, brand enthusiasts are able to buy exclusive denim festival merchandise and personalize it with free laser customization specific to the event. A complete line of Lollapalooza by Wrangler apparel, including tees and denim, is available on [Wrangler.com](https://www.wrangler.com).

Finally, we are really excited to amplify Wrangler's 75<sup>th</sup> anniversary with an upcoming New York City event, including a preview of our Wrangler Leon Bridges collection, followed by a performance by the Grammy Award winner himself. I know some of you on this call will be joining us for that event. We can't wait to share this with folks.

As you can see, we have an incredible amount of brand elevating activation with both brands. And we will continue to invest behind these demand creation efforts to drive brand equity, consumer reach, and top-line growth in 2022 and beyond.

So, let me now close with how we think about the go-forward. As you've seen, we lowered our outlook today, not necessarily an indication of the healthy momentum we are experiencing in our own business. Recall from our initial guide back in March, we anticipated the back half to be more greatly impacted by these factors but to reflect an even more conservative view of the macro background, particularly retailer inventory rebalancing and ongoing lockdowns in China.

Despite the macro headwinds, we remain focused on executing our strategies. As we've stated frequently, we anticipate that future revenue will be driven by outsized growth in category, channel, and geographic expansion. This is important as we look to diversify our portfolio beyond U.S. wholesale. As I said earlier, this doesn't happen overnight. We are absolutely investing in those accretive areas.

First, channel diversification in enhancing our digital platform while leveraging our global brick-and-mortar learnings to further develop a holistic, full-priced, D2C omnichannel experience for our consumers. While we have established a target of 10 percent digital penetration by 2023, our opportunities to vertically integrate our D2C model showcase Pinnacle product and more directly connect with our consumer are much greater and, importantly, at accretive margins.

From a category perspective, you have already seen the tremendous strides we have made to evolve our product portfolio beyond denim bottoms. But, we remain in the early days. And what we love is the breadth of this category growth across Western, outdoor, work wear, tees, female, and really importantly, its authentic, natural extensions that leverage each of the brand's evenness.

And finally, turning to international expansion, we remain highly under-indexed in markets outside of the U.S. as most of our peers do nearly 50 percent of their business international, so a significant opportunity for us to nearly double the size of our business over time. As we've discussed, we expect macro pressures to weigh on international, particularly China, over the near term. But, we continue to aggressively invest in positioning ourselves for substantial long-term growth across both Asia and Europe.

Highlighting this investment to enhance growth, I'm excited to announce today that in Q3, we made the decision to further globalize our operating model, including the relocation of our EMEA headquarters to Geneva, Switzerland. With the implementation of our global ERP infrastructure and foundation now complete, it's the ideal time for us to further drive global operating efficiencies and accelerate our transition to a growth-oriented organization.

The long-term benefits of these actions are significant, including providing greater capital efficiency, improving go-to-market capabilities, enhancing access to best-in-class talent, and driving SKU rationalization. The announcement reflects our commitment, even when macro conditions remain difficult, to continue to strategically invest for long-term, sustained, profitable growth.

We also recognize the need to be agile in this environment, and we will accordingly look to tighten nonstrategic expenses. Further, the significant actions we've taken over the last several years to fortify our balance sheet and optimize our capital structure afford us increased flexibility to navigate the choppy waters.

These moves, coupled with our proven, strong cash flow generation, even in periods of macro uncertainty, give me great confidence that Kontoor will continue to accelerate our competitive separation. Rustin?

### **Rustin Welton**

Thank you, Scott, and thank you all for joining us today. I know you all have questions on a number of macro topics, including consumer demand, inflationary pressures, and retailer inventory rebalancing. So, I'll begin by discussing some of these key external factors before reviewing our second quarter performance and closing with how both are incorporated in our updated 2022 outlook.

Let's begin in the U.S. As Scott mentioned, many retailers began to rebalance inventory levels during the quarter to better reflect supply and demand signals in the marketplace. While retail apparel inventory levels have been well promulgated (sp) on a macro level, I want to dig a little more into specifically our core categories and how our brands performed at point-of-sale.

Over the past three months, the U.S. total measured market for denim bottoms, casual pants, and seasonals grew in the low to mid-single digits across both men's and women's segments,

with men's categories performing a bit better than women's. In men's bottoms, our largest core segment, Wrangler and Lee significantly outperformed the market in our key categories of denim and casual pants.

As we have stated previously, we believe consumers migrate to trusted brands in times of uncertainty. With the investments made in product, innovation, and demand creation that Scott outlined. The value proposition of Wrangler and Lee is as high as ever. And we saw this resonate with consumer during the quarter at point-of-sale.

In women's, there was disparity across the portfolio, with strength in casual pants and softness in seasonals. But, Wrangler and Lee outperformed the market in the majority of categories. And while market softness in the seasonal category is noteworthy, it is a key rebalancing focus for retailers, with discounting taking place prior to end of season. Our seasonal business has outperformed the market to date.

On a broader level, retail inventory challenges have led to more restricting open-to-buy dollars that adversely impacted our second quarter shipments and are expected to continue into the back half. But, stepping back, we are very pleased with how Wrangler and Lee performed at point-of-sale in the U.S. We are clearly winning on a relative basis and how consumers continue to embrace our brands and offerings in our core categories.

In the international markets, the quarter generally played out as anticipated. In China, Shanghai reopened in line with our expectations during the quarter. But, citywide lockdowns and restrictions on movement in a number of jurisdictions, such as Chengdu, Shenzhen, and most recently, Wuhan, remain.

These restrictions are impacting consumer behavior and brick-and-mortar traffic and are contributing to a more conservative outlook for the back half. In Europe, FX pressures accelerated in the quarter, with the Euro and U.S. dollar at parity for the first time in two decades. And we expect currency headwinds to continue to temper results.

Turning to supply chain, inflation on input (sp) costs, such as cotton and crude oil, which affects great surcharges, spiked during the quarter to year-to-date highs before moderating to end Q2. We are not assuming a significant benefit from recent commodity reductions in the second half of 2022, given the six- to nine-month lag time on impacting our P&L on many of these inputs.

With this backdrop, let's review the second quarter results. Beginning with revenue, global revenue increased 27 percent compared to the prior year. Growth was driven by strength in the U.S. across the digital and wholesale channels. On a regional basis, U.S. revenues increased 40 percent, driven by continued broad-based momentum.

In addition to strength in our core, we are encouraged by the progress we are making in diversifying the business into new categories, such as outdoor, work wear, and (inaudible), all



of which delivered strong growth in the quarter. And in our digital business, U.S.-owned.com increased 24 percent compared to the prior year, supported by our distorted investment in digital, which are driving improved traffic in AURs. International revenues decreased 11 percent. As expected, COVID-related lockdowns in China in comparison to the EMEA ERP implementation in 2021 weighed on the quarter.

Turning to our brands, global revenue of our Wrangler brand increased 36 percent. Growth was driven by continued momentum in the U.S., including strong contributions from Western outdoor and work wear. In addition, we saw a strong growth in tees, which increased triple digits compared to the prior year. In Wrangler's digital business, USowned.com increased 28 percent in the quarter. Wrangler international revenue increased 8 percent with gains in non-U.S. Americas, partially offset by timing shifts related to the 2021 ERP implementation in Europe.

Turning to Lee, global revenue increased 12 percent. Lee U.S. revenue increased 40 percent, driven by momentum in performance and comfort styles as well as new product platforms. We also saw strength in digital, with USowned.com increasing 14 percent and U.S. digital wholesale up 97 percent.

Lee International revenue decreased 22 percent. As discussed, COVID-related lockdowns in China had a significant impact on the quarter, particularly in April and May. We did see a sequential improvement as lockdowns eased, particularly with our digital business, which saw double-digit increases in June. And finally, from a channel perspective, U.S. wholesale increased 44 percent. Non-U.S. wholesale decreased 10 percent. And globalowned.com increased 10 percent.

Now onto gross margins. Gross margin decreased 260 basis points compared to adjusted gross margin last year. As we discussed last quarter, we continue to see elevated transitory costs, including air freight. These factors resulted in a 170 basis point headwind in the quarter. In addition, unfavorable geographic mix shifts, resulting from China lockdowns and ERP-related timing shifts in Europe, resulted in a further 150 basis point decline.

Partially offsetting these headwinds were the benefits from strategic pricing, which more than offset product cost pressures in the quarter. SG&A expense was \$178 million, or an \$11 million increase versus first quarter of 2021, adjusted SG&A. As a percent of revenue, SG&A leveraged by 510 basis points in the quarter, demonstrating the benefits of our highly efficient model and multiple levers to support profitability, while still investing behind key growth enablers, such as demand creation, digital, and IT.

Earnings per share was \$1.09 compared to \$0.70 in the same period in the prior year on an adjusted basis. Now, turning to our balance sheet, second quarter inventory increased 33 percent compared to last year. Compared to pre-pandemic 2019 levels, inventories were flat.



We finished the second quarter with net debt or long-term debt less cash of \$647 million and \$145 million in cash and equivalents. Our net leverage ratio or net debt divided by trailing 12-month adjusted EBITDA at the end of the second quarter was 1.6 times, within our targeted range of 1 to 2 times.

Finally, during the quarter, we repurchased \$40 million in common stock. And at the end of the quarter, we had approximately \$62 million remaining under our share repurchase authorization. When combined with a strong dividend, we returned a total of \$65 million to shareholders during Q2.

Before we review key assumptions regarding the outlook for the balance of the year, I'd like to take a moment to reflect on our first half results. In March, prior to COVID lockdowns in China, retailer inventory rebalancing efforts in the U.S. and incremental inflationary pressures, we provided a supplemental breakdown on our first half outlook, given our ERP implementation in 2021.

Specifically, we indicated that we expected global revenue in the first half of \$1.29 billion to \$1.31 billion, or a 13 percent to 15 percent increase, compared to 2021. Although the quarter has unfolded differently than expected due to macro factors, our first half revenue grew 14 percent in constant currency compared to 2021.

Similarly, on the bottom line, we indicated in March that we expected first half GAAP EPS of \$2.40 to \$2.60 per share, or a 13 percent to 22 percent increase compared to 2021 adjusted EPS. We delivered GAAP EPS of \$2.49 in the first half, an 18 percent increase in constant currency, compared to 2021 adjusted EPS.

Despite the many factors we have discussed, we were able to deliver top and bottom line results right in the middle of our expectations. Our agility and focus on execution, combined with our brand momentum in the marketplace, clearly gives us confidence to navigate future uncertainty.

So, how are we thinking about the second half in light of everything I just covered? Let's begin with revenue. In our previous outlook from last quarter, we mentioned that we expected the first half global revenue to increase in the mid-teens range, with full-year global revenue to increase at approximately 10 percent, compared to 2021. This guidance implied a mid-single-digit increase in the second half. Notably, we were already incorporating anticipated consumer demand softening, due to inflationary pressures.

Our updated outlook now assumes second half global revenue to be relatively flat compared to 2021, driven by two primary factors. First, we anticipate open-to-buy dollars to be somewhat restricted as actions to rebalance retailer inventory levels are implemented. We expect these issues will weigh on our top line more than originally anticipated, with the third quarter more pressured than the fourth quarter.

Second, given the ongoing COVID restrictions and lockdowns, we believe China will remain a challenging market and now believe that it's prudent to take a more conservative approach to our second half outlook.

In sum, we delivered global revenue growth in the first half of 14 percent in constant currency, driven by U.S. growth of 19 percent compared to 2021. With our more cautious updated outlook, we now expect second half global revenue to be relatively flat, compared to 2021. In terms of gross margin, a few items to call out.

Inflationary pressures that peaked during the second quarter will continue to pressure gross margins as will the retailer inventory rebalancing, an adverse geographic mix from a more conservative approach to China. We expect these headwinds will be somewhat offset by lower transitory expenses, such as air freight, and continued structural makeshifts to accretive channels and strategic pricing.

Last, I want to spend a moment on SG&A. Importantly, first and foremost, we will continue to make thoughtful, strategic investments, as Scott highlighted, including digital, international, and the globalization of our operating model to accelerate diversified, accretive growth over the long run.

However, in light of the uncertain macro-economic environment, we expect tighter expense controls on nonstrategic and discretionary items. Additional details on our outlook can be found in today's earnings release. But, to summarize, revenue is now expected to increase approximately 6 percent for the full year, with second half relatively flat compared to 2021.

The third quarter is expected to experience greater pressure relative to the fourth quarter. Gross margin is now expected, to approximately 43.5 percent compared to adjust gross margin of 44.6 percent achieved in 2021. We expect gross margin year-over-year headwinds to moderate in the second half, with the third quarter experiencing greater pressure relative to the fourth quarter.

Adjusted SG&A, excluding an estimated one-time charge of \$18 million associated with our globalization efforts and European headquarter relocation, is now expected to increase at a mid-single-digit rate, compared to adjusted SG&A in 2021, relatively consistent with revenue growth.

Adjusted EPS, excluding an estimated one-time charge of \$0.25 per share associated with our globalization efforts and European headquarter relocation, is expected to be in the range of \$4.40 to \$4.50 per share. Finally, I want to briefly provide some comments regarding inventory, cash flow, and capital allocation. Since the spend, we have discussed actions to improve our inventory metrics.

Looking back to 2019, our inventory levels are flat, despite higher 2022 projected revenues. Given the U.S. retail inventory rebalancing efforts during the quarter, our inventory levels did finish higher than expected, but importantly, we feel good about the quality as the majority is in poor evergreen styles (sp).

And we will be working to sequentially improve from these levels in the second half. Additionally, Q4 is historically the highest generating quarter from cash from operating activities. And we expect this to continue in 2022. As we have discussed, we remain confident in our capital allocation optionality, which provides us with tremendous flexibility in times like these.

We are clearly operating in a highly dynamic environment, but I want to be clear. We remain laser focused on executing our Horizon 2 strategies, investing behind profitable growth initiatives to transform the model, while delivering long-term sustainable shareholder returns.

This concludes our prepared remarks, and I will now turn the call back to our operator. Operator?

**Operator**

Thank you. The floor is now open for questions. If you do have a question, please press star, one on your telephone keypad at this time. Again, ladies and gentlemen, if you would like to ask a question, please press star, one on your telephone keypad at this time. Please hold while we poll for questions.

Our first question comes from Jay Sole with UBS. Please state your question.

**Mauricio Serna**

Hi. Good morning. This is Mauricio on behalf of Jay Sole, and thanks for taking our questions. Just a couple of questions from our side. Maybe if you could speak a little bit about the confidence that you have on this updated fiscal year '22 outlook. How do you feel like these numbers are compared, like the level of risk that you perceive in these numbers prior to the previous outlook?

And maybe if you could speak a little bit more about how you're seeing broad consumer demand, especially in your core U.S. business, how that evolved during the quarter and what you've seen so far into Q3. Thank you.

**Scott Baxter**

Hey, Maurice. This is Scott. I'll start, and then I'll just hand it over to Rustin. And I'll speak a little bit about the consumer and our outlook, and then Rustin will follow up. But, in our prepared remarks, we really, really understood the challenges that we all face. And we did a very thoughtful review of our business. So, that's why we came today with our updated outlook. Hopefully, everybody understands the analysis and the thought that went into that.

And we are right now really working on controlling what we can from a business standpoint, so as we think about the consumer and think about what's happening out in the marketplace right now, all the investments that we've made in our business through the last four years, the investments in the product, the investments in the design, specifically the investments in the brands themselves that hadn't been made before are really starting to pay off in the marketplace.

And I feel, and the team feels, really strongly about our fundamentals and our strategy right now. And I think the thing, that when you couple that with our really strong cash flow and the investments that we can continue to make in the business, I think that puts us in a really good position going forward. And you saw that in the results today, right? You saw that in the first half, you saw that in the first quarter, and even in our updated outlook, as we've looked at it.

And we understand the dynamics of the current marketplace that we're working in. But, we're going to continue to invest in the core. We're checking really well in the core, which gives us great confidence. We're going to continue to invest in our channels, our geographies and our categories and tees and work and the outdoor space, which really advantages us going forward.

And I think the thing that I want to leave you with, which is really important to us, is the big advancements we've made in our brands. And that's giving us real pricing power that we've never had before in these brands. And it's given us a real conversation to weigh with the end consumer.

But, you think about some of the comments that I made in my prepared remarks. We've invested in the Bonnaroo Festival. Something like that would have never happened before with Lee. The investment that we've made in Lollapalooza with Wrangler and Wrangler's 75<sup>th</sup> anniversary and some of our different collabs that we've had with like The Hundreds. So pleased, not happy. We will continue to work real hard. And then, I'll flip it over to Rustin to go ahead and talk a little bit about the outlook. Thanks for the questions.

### **Rustin Welton**

Thanks, Scott. Good morning, Mauricio. Thanks for the question. First, I'll start with a comment. As Scott mentioned, I think the investments that he talked about that we're making in the brands, particularly in product and demand creation, are really important. It's really driving that value proposition we offer consumers. And that is as high as it has ever been. You're seeing that in the strong sell-throughs that we talked about in the prepared remarks in the second quarter and the double-digit increases on our own us.com.

So, additionally, maybe a little bit more context. Many of the price increases have already been put in place at retail. And I'd remind everyone, we were strategic with our price increases. While it's still early, we're seeing a favorable response, as seen in the strong POS. That said, as

we talked about, we do expect open-to-buy dollars to be more restricted until the broader inventory levels are rebalanced.

And we're certainly taking a more conservative view on China in this updated outlook. We've incorporated this into our updated guide. And just maybe closing, Mauricio, with one point. We expect the second half revenues to be relatively flat, compared to 2021, as we said, versus the first half, where we were up 14 percent globally in constant currency. So, hopefully, that gives you a little perspective between Scott's comments and mine on how we're thinking about revenue. Thank you.

**Mauricio Serna**

Thank you very much.

**Scott Baxter**

Thanks, Mauricio.

**Operator**

Okay. Our next question comes from Bob Drbul with Guggenheim Securities. Please state your question.

**Bob Drbul**

Hi. Good morning. Just a couple questions for me. Just further on the gross margin, the expectations of Q3 into Q4, how much visibility do you have on, a little bit on support of the retailers as they continue to work down the inventory levels and what your commitments are around the brands?

And then, the second question I have is just, on the inventory levels at retail, where do you think we are in terms of the readjustments? Do you think it's a three-month readjustment? And how are you really adjusting your own manufacturing plans over the next few quarters? Thanks.

**Scott Baxter**

Hey, Bob. How are you? Thanks for the questions. Hope you're doing well. I'll go ahead and start a little bit on the support. We talked a lot about and put a lot of emphasis on making sure that we understand the business going forward and feel really confident where we are from an outlook standpoint.

Our product at retail has checked really well, which is the thing that we're really happy about. But, I think the key here is, and I'll just kind of touch on it before I hand it over to Rustin for the other two, is that we've been real thoughtful about the investments that we've made behind the brands. We've been real thoughtful about the design and the direction of the brands and winning with winners.

So, for us, from the standpoint of the rebalancing that's been going on, our position is strong and continues to be very strong going forward. So, please put the work that our teams have done globally in that respect. Rustin, you want to go ahead and take the rest?

**Rustin Welton**

Yeah. Thanks, Scott. Morning, Bob. I'll go ahead and start with the gross margin question you had. Again, we updated the outlook this morning, Bob, as you're well aware. We now expect gross margins to be approximately 43.5 percent for full-year '22. That does compare to about 44.6 percent in '21. And obviously, our prior guide was consistent with '21.

As you indicated in your question, we do expect Q3 to be more pressure than Q4. And that really is taking into consideration the two factors we talked about on the revenue side that are impacting the back half outlook, specifically the more conservative view on China and then the retailer rebalancing efforts.

The guide for the second half, Bob, does imply about a 42.8 percent gross margin. That is down about 50 bps versus the back half of '21. Maybe just breaking down a little bit where we see some of those puts and takes. On the headwinds side, and the prepared remarks talked a little bit about inflationary pressures on input costs, they continue, certainly spiked in the second quarter and moderated somewhat off of the recent peaks.

But, we're not assuming benefit as it takes, as we've talked about in the past, a few quarters to flow through our P&L. The second sort of major headwind that's out there is certainly the unfavorable geographic mix shifts from the more conservative view on China I just mentioned.

There are some tailwinds as well in those numbers. Certainly, the structural mix shifts to accretive channels you've seen us deliver over a number of quarters here will continue as we're distorting investment there. Strategic pricing. As we talked about previously on the calls, have been very thoughtful about how we've taken pricing, particularly in the front and back half of the year.

And then, air freight should get incrementally better in H 2 (sp) but still will be a net headwind for the year. Maybe if I shift over to inventory a little bit, our inventory did finish at just under \$540 million. That was up about 33 percent to prior year. As you heard me comment, Bob, on the prepared remarks, I think it's really telling, and important to highlight, that that was flat relative to 2019 on full-year '22 revenue that's expected to be up versus '19.

So, Scott mentioned it. We're really seeing strong POS on a relative basis in both men's and women's on the retail side. Certainly seasonals, as I talked about in my prepared remarks, have been an area of softness, which retailers are working through. But, our seasonals have outperformed the market to date, and then certainly the broad retail and inventory imbalances have had an impact on the open-to-buy dollars and the shipments that have affected inventory as well.

So, we're working to sequentially improve inventory positions as we go through the year, but I think it's really important that the quality of our inventory is healthy, as it's most in poor evergreen styles. In terms of how we're modifying and managing that, Bob, I would just say, as we've talked about in previous calls, we try and stay very, very close to our retail trade partners on trends that they're seeing and certainly have the agility to modify and react quickly to changes that they see in the demand signals, including the retail inventory rebalancing efforts that are ongoing.

So, hopefully, that provides a little more clarity. Thanks for the question, Bob.

**Bob Drbul**

Great. Thank you.

**Scott Baxter**

Thanks, Bob.

**Operator**

Our next question comes from Paul Kearney with Barclays. Please state your question.

**Paul Kearney**

Hi, everybody. Thanks for taking my question. I guess, my question is on your long-term targets from your Investor Day, the \$5-plus in EPS and \$46-plus in gross margin. How shall we think about the achievability of those and maybe a potential timeline for those and whether that's (inaudible)?

**Scott Baxter**

Rustin, you want to go ahead?

**Rustin Welton**

Yeah, yeah. Thanks, Scott. I'll take that. Morning, Paul. Since we hosted our Investor Day back in May of '21, we've seen a lot, Paul, what's happened in the market, certainly hyper-inflation, war, retail inventory rebalancing. Yet, I think it's really important to stress that the underlying strategies that we laid out at our Investor Day are driving diversified, accretive growth. And they remain intact, as you heard us talk about today in Scott's remarks, about channel, about geographic, about category extensions.

So, obviously, we won't guide '23 today, but maybe if we step back and look at it on a broader scale. Because 2021 was ahead of our plans on a revenue and EPS basis. And for '22, with the updated outlook we laid out today, we're targeting revenue of greater than \$2.6 billion with \$4.40 to \$4.50 in EPS. So, structurally, feel really positive about the strategy that we have. And certainly as we get later into the fall, we'll talk a little bit more about timing and how it relates to '23.



**Scott Baxter**

Thanks, Paul.

**Paul Kearney**

Thanks. Just one more for me, if I may. Just curious on kind of the price (inaudible) just in line with consumer pressure, inflationary pressure and inventory (inaudible), but retail partners. How do you see in the future price increases? Do you have any plans (sp) for the back half? And then, what are you seeing in terms of the consumer response on your strategic (inaudible)?

**Scott Baxter**

I'll go ahead and take that, Paul. And if Rustin wants to chime in, he can. Paul, we look at it like this. At the end of the day, we need to make great product that our consumers really love and that they want to take out. We are seeing that right now across our businesses. We're seeing it across the globe, we're seeing it across different channels and geographies, the investment that we've made in the design teams here for both Wrangler and Lee that we hadn't had before.

And key is the investments that we're making behind the brands. I would tell you for the first time, and I've been involved with this business for 15 years, for the first time here these last two years, and it's accelerating, we are seeing our ability to take price and having pricing power and to have that stick. Our brands are really, really resonating with the consumer. And we're seeing in social media, we're seeing it in different age groups, which is extremely important to us.

And we're seeing it from different locations, different places, different geographies. So, we'll continue to work really hard at that. But, I do want to make it very clear that we do have pricing power. Our brands are strong. They're resonating. And we're going to continue to make those investments because our cash flow, as you know, is very strong. And even in difficult times, we're able to do that, and we will do that.

**Paul Kearney**

Perfect. Thanks, Scott. One more.

**Rustin Welton**

I would just--Paul, I would--.

**Paul Kearney**

Oh, go ahead.

**Rustin Welton**

I was just going to add, Paul. I think the investments Scott is talking about really allow us to mix up in AURs as well, as you heard us talk about in those prepared remarks. And that

combination of mixing up an AUR, the strategic pricing we're taking, as well as cost savings initiatives that we've had, as you've heard us talk about in the last couple of quarters, really important the combination of those to offsetting some of the inflationary pressures that we're seeing from a margin perspective.

**Paul Kearney**

Thanks. And a quick one.

**Scott Baxter**

Thank you, Paul.

**Paul Kearney**

What is the timing of the EMEA headquarter shift?

**Scott Baxter**

So, Paul, that timing is now. But, let me go ahead and step back and just take everybody through kind of our process and our thought process. When we spun off three years ago, and when we, a little over three years ago, and when we made the decision to do this actually four years ago now, we had a very fractured business. So, what I mean by that, and I know you've all heard me talk about that, is we built product in five different locations around the world and did not communicate with each other.

So, Lee was building product in U.S., South America, Mexico, China. And the teams weren't talking, building, working together. Same thing with Wrangler. Our systems didn't combine. And we embarked upon two really fundamental projects for this business. We went ahead and implemented a VRP system. I know everybody on this call knows the difficulty of that, so that our teams could work cohesively around the globe.

We didn't have one system. We pulled out of another company that didn't have one system because their businesses were run from a geography standpoint. And then, the other piece is we embarked upon globalizing this business. So, when you pull those two big strategies together, globalizing the model across the world and then having an ERP system that can support that globalization, we now are moving to one location.

And that fundamentally is going to really help us for a lot of reasons. I mean, if you think about what it's going to do for us, it's going help us from a capital efficiency standpoint, like I talked about. It's going to improve our go-to-market capabilities significantly from a product, people, and customer standpoint.

And then, in addition to that, it gives us access to a real apparel market in Switzerland. It gives us access to really good talent and then helps us from the standpoint of how we think about our SKUs from a rationalization standpoint across the globe, so lots of advantages, lots of reasons to do it, lots of thought that went into that. And that's happening right now.

Thank you for the question, Paul, appreciate that.

**Paul Kearney**

Thank you. Bye.

**Operator**

Our next question comes from Brooke Roach with Goldman Sachs. Please state your question.

**Brooke Roach**

Good morning, and thank you for taking the question. Scott, my question is on marketing investments, which have been a big focus for Kontoor this year. But, I think I heard in the prepared remarks that Kontoor is looking to tighten up expense controls as a result of some of these macro headwinds.

Can you clarify your plans for demand accretion (sp) into the second half? Any big innovations or campaigns or launches that we should be on the lookout for? And then, where are the areas (inaudible), that you can really flex down your spend as a result of this tighter macro?

**Scott Baxter**

Yeah, got it. I'll go ahead and take the first part, and then I'll hand over to Rustin for the second part. We, as you know, we've outlined our cash flow and our strong optionality. So we have the ability to do multiple things in the marketplace at the same time. One of the things that we've made a decision on here, Brooke, is that we're going to continue to invest behind the brands in a pretty significant way.

One of the things that we don't want to do is we don't want to stop the momentum that we have. We have created really good momentum. We've got this really good machine working right now in that we're globalizing the product line, we're creating really good product that's taking out really well. You heard us talk about, our POS is checking extremely well.

In addition to that, we've got really good, talented people that are creating great designs that our consumer really likes. And then, behind that, we're doing, and I can talk about some of the most recent stuff. So, this weekend was the Lollapalooza Festival in Chicago. And we had our first-ever store there. And it was an incredible store we got really good feedback from that we had a ton of product at.

We just finished Bonnaroo, and we've got Austin City Limits coming up, we've got Lollapalooza coming up and Berlin. And we're not backing off of those investments. The 75<sup>th</sup> anniversary of Wrangler, we're just not doing it. We are going to continue with our demand product and how we think about it. And it's going to accelerate as '22 goes on and into '23. So, focus, focus, focus on these brands because they haven't had it before.

And the single most important thing I would tell you, and we come back to this all the time, is we have put energy and money and really good thoughtful campaigns behind these two big, big, powerful brands. And it has worked. The consumer has accepted them in a really significant way.

Rustin, you want to talk about some of the other, the other piece of that?

**Rustin Welton**

Yeah. Thanks, Scott. Good morning, Brooke. Certainly, Scott hit it. We're going to invest behind the brands strategically, Brooke. You need to be sure of that, as you saw us do this morning with the globalization and the European headquarter move. But, we are in the uncertainty, certainly looking at heightening discretionary and nonstrategic spend. That certainly is involving scrutinizing spending across all categories.

As we have open positions that become available, we're certainly going to take a fresh lens at those type of positions and make sure that they're needed. Same goes for whether it's travel or it's training or other factors like that. So, we're going to look at every spend that's out there and be very wise with it, as you would expect us to be in this type of environment, while continuing to invest in the business. I think that's the key takeaway. Thanks, Brooke.

**Scott Baxter**

Thanks, Brooke.

**Brooke Roach**

If I could just ask one follow-up, on China and the more conservative view that you're taking there, Rustin, can you help us understand the proportion of the second half fails and gross margin guidance reduction that's attributable to the weaker China outlook versus the headwinds that you're seeing in the macro in the United States?

**Rustin Welton**

Yeah. I think, Brooke, certainly I'm not going to guide on a particular country, as you would expect. But, I think if you step back, and you look at China, the quarter largely played out as expected, as you heard us talk about a little bit on our prepared remarks. Certainly, the Shanghai reopening was in line with our expectations.

And we saw sequential improvement as the quarter progressed, including both in our brick-and-mortar doors and our ecomm, which saw double-digit growth in June for Lee. Certainly, there's a lot of uncertainty out there, though. We've seen lockdowns and movement restrictions that have impacted other jurisdictions, including Chengdu, Shenzhen, Wuhan. Those remain.

I think last quarter, we talked a little bit about taking a conservative approach to Q2 and a more cautious outlook in the back half of the year. Certainly, we're going to take a more

conservative approach in the back half assumptions, given some of those factors. Certainly pleased with some of the reopenings that have taken place according expectations but lots of uncertainty that's there.

But, I would just say as it relates to China, Brooke, where I would leave this is, we really continue to believe in the long-term opportunity for both Wrangler and Lee in the region. And to really hit upon Scott's point, we're going to continue to invest to make sure that these brands are strong and healthy as the region reopens appropriately. So, hope that helps a little bit more, Brooke, about how we're thinking about China.

**Scott Baxter**

And, Brooke, I would make one kind of broader comment beyond China. We really have an opportunity internationally for these brands. And some of the actions that we've taken today with our new headquarters in Europe as we've talked about the how and the why, we believe that we're under-indexed here relative to our peer set.

I think that there's a really nice runway here for a very long time as these brands gain acceptance across the globe and we enter new categories and geographies. So, from a broader standpoint, really like where we are, very early in the game and feel like we'll catch up very quickly here now that we've got the right operating systems to do that. Thanks, Brooke.

**Brooke Roach**

Thank you.

**Operator**

And our final question comes from Will Gardner with Wells Fargo. Please state your question.

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**Will Gardner**

Hey, thank you, guys, for the question. Guys, I just wanted to ask about promotions in the channel. I know you guys, you have Walmart, Target, excuse me, optimizing their inventory. I just want to know how you're thinking about it for the balance of the year with going into a holiday and back to school. We, you heard Under Armor talk about this yesterday, how they're making a lot more promotions for the rest of the year, so just want to know how you're thinking about that and, secondly, how that's impacting your merch margin. Thank you.

**Scott Baxter**

Will, I'll go ahead and start, and then Rustin will take it from there. But, from our standpoint, we're building product that's checking. And people really like our product. It's resonating really well. So, we think that we'll have limited promotions going forward.

We put ourselves in a really good position, a combination of our marketing and our brand campaigns relative to really good design and product and then making sure that we understand our consumer, and aligning with the right customer, too, from that standpoint. So, not going to

be, we don't believe we are in a position that we have to be over promotional at all for back to school and/or holiday.

Rustin, you want to talk a little bit about the rest?

**Rustin Welton**

Yeah. I would just add, Will, again, if you step back, as you know, our model, our top four customers, Walmart, Amazon, Target, and Kohl's, not necessarily in that order, certainly most of those have not been promotional in nature. Certainly, the retailer rebalancing efforts have been well chronicled here. But we like how we're positioned. And to Scott's point, we're really focused on delivering product that really resonates with the consumer and delivering on that compelling value proposition that we talked about earlier.

So, we've taken, certainly, the global landscape into consideration in our outlook that you've seen here this morning.

**Scott Baxter**

Thank you, Will.

**Rustin Welton**

I think your--.

**Will Gardner**

--Sorry, go, yeah.

**Rustin Welton**

Go ahead, Will.

**Will Gardner**

So, yeah, my other question was just on AURs, just how they were in the quarter and, yeah, how the promotional environment impacted those, if at all.

**Scott Baxter**

Rustin, you want to take that?

**Rustin Welton**

Yeah, we talked a little bit about, yeah, we talked a little bit, Will, about AURs in our prepared remarks. We didn't break it out specifically by the quarter. But, I think what, the AUR growth that you've seen in double digits relative to '19 again really speaks to everything we've highlighted on the call this morning. It's the investments that we're making, it's mixing up into that a higher product as well as strategic pricing that's out there.

So, again, as I commented a little bit earlier with Bob, as how we're thinking about gross margins, it's really that combination of mixing up into the AURs cost saves and certainly h pricing that we're using to offset the inflationary impacts and the business, the combination of those. And we've been very thoughtful and strategic about how we're thinking about pricing, but really pleased with how the brands have moved and the momentum that we've seen in the AURs.

**Scott Baxter**

Thanks, Will.

**Will Gardner**

Great. Thank you so much.

**Rustin Welton**

Thanks, Will.

**Operator**

That was our final question. I'll turn it back over to Scott for closing remarks.

**Scott Baxter**

Well, folks, thank you for the interest in our company. We really appreciate it. And thank you for all the thoughtful questions today. And I just want to leave with this about, rest assured that we are taking all the right and necessary steps to run this business in a really sophisticated way. We really like how we've positioned ourselves going forward and how we're going to position ourselves coming out of this very dynamic marketplace.

I think that's going to differentiate a lot of companies here as we go forward. And we really look forward to talking to you about how that process in Q3. So, look forward to the next time we get together. Thank you for the support, and thank you again for today. Have a great day, everybody.